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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Mr. Gregory J. Vogt, Chief
Tariff Division
Federal Communications Commission
1919 M Street N.W., Room 518
Washington, D.C. 20554

re: CC Docket No. 92-24

Dear Mr. Vogt:

Pacific Bell ("Pacific") has twofold concerns about the methodology proposed by the Commission staff for LIDB rate development. First, it is inappropriate to require that

Pacific Bell's Proposed LIDB Rates are Cost-Based and Meet the Price Cap Guidelines:

In developing its proposed rates, Pacific applied appropriate overhead loadings to direct costs in compliance with the Commission's price cap guidelines.

In developing the incremental direct unit costs, Pacific used a forward-looking rather than an embedded mix of technology to more accurately reflect the type of equipment which would be used to provide LIDB. Pacific used its SCIS model to identify incremental unit investment levels for LIDB. The unit investments were then multiplied by annual capital and expense factors specific to that particular type of investment to produce incremental direct unit costs.

Appropriate overhead loadings were then developed using the following steps: 1) The 1990 total switched access costs were divided by the 1990 switched access minutes of use to produce an average unit cost for all switched access services; 2) that average unit cost was then divided by Pacific's average per validation service. Pacific's pricing strategy of a 3¢ LIDB rate reflects sound business practices in a competitive environment.[2]

The Staff's Proposed Pricing Methodology is Seriously Flawed:

Pacific understands the proposed LIDB costing methodology to be as follows. (The calculations discussed below use data provided on Attachment 1.)

1. Calculate "floor" and "ceiling" direct cost ratios from ARMIS data by dividing L.25 by L.1 and L.26 by L.1. These ratios are matched against the direct cost ratios filed by the LEC to test reasonability.

2. Calculate a maximum overhead loading factor from ARMIS data by dividing L.31 by L.25.

3. If the filed direct cost ratios fall within the range developed in #1 above, the maximum overhead is determined by multiplying the maximum overhead factor by the LEC's direct costs. The "ceiling" price is then calculated by adding the LEC's filed direct costs and the computed maximum overhead costs.

This approach is not reasonable because:

1. ARMIS is based on composite historical data which reflects the average investment necessary to support a variety of switched access products. For new service offerings it is more appropriate to build the costs around the type of investment the service will actually employ -- in other words, to use a service-specific forward-looking costing approach. The direct costs Pacific developed were based on annual cost and expense factors which are applicable to LIDB investment and are consistent with its service-specific forward-looking costing approach.

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2 The Tariff Division staff has also questioned the costing methodology used to develop the SS7 port charge that is used with LIDB service. Pacific's SS7 link and port charges current recover costs associated with various forms of SS7 interconnection. Pacific plans to restructure those charges to more appropriately recover specific types of SS7-related costs from the specific cost causers.

2. The proposed ARMIS maximum overhead factor will

1991

DIRECT COSTS AND OVERHEADS
($ THOUSANDS)

	CLASSIFICATION		
	INVESTMENT		
1	INVESTMENT – COE + IOT + CWF		
2	INVESTMENT – GSF		
3	TOTAL (LN 1 + LN 2)		
4	COE + IOT + CWF FACTOR (LN1 / LN3)		
5	GSF FACTOR (LN2 / LN3)		
	NET INVESTMENT		
6	NET INVESTMENT – COE + IOT + CWF		
7	NET INVESTMENT – GSF		
8	TOTAL NET INVESTMENT (LN 6 + 7)		
9	NET INVESTMENT FACTOR – COE + IOT + CWF (LN 6 / 8)		
10	NET INVESTMENT FACTOR – GSF (LN 7 / 8)		
	CAPITAL COSTS		
11	PLANT SPECIFIC EXPENSE – COE + IOT + CWF		
12	PLANT SPECIFIC EXPENSE – GSF		
13	DEPRECIATION/AMORTIZATION EXPENSE		43-04
14	DEPR/AMORT – COE + IOT + CWF		
15	DEPR/AMORT – GSF		
16	FEDERAL INCOME TAXES		
17	FIT – COE + IOT + CWF (LN 9 * LN 16)		
18	FIT – GSF (LN 10 * LN 16)		
19	STATE AND LOCAL TAXES		
20	STATE AND LOCAL INCOME TAXES		
21	ST & LOC INC TAX – COE + IOT + CWF (LN 9 * LN 20)		
22	ST & LOC INC TAX – GSF (LN 10 * LN 20)		
23	NET RETURN – COE + IOT + CWF (LN 6 * 0.1125)		
24	NET RETURN – GSF (LN 7 * 0.1125)		
25	DIRECT COSTS – LOWER LIMIT (LNS 11+14+17+21+23)		
26	DIRECT COSTS – UPPER LIMIT (LNS 11+14+17+21+23+27+28)		
	OTHER COSTS		
27	PLANT NON-SPECIFIC		
28	CUSTOMER OPERATIONS – MARKETING		
29	CUSTOMER OPERATIONS – SERVICES		43-01
30	CORPORATE OPERATIONS		
31	TOTAL COSTS (LNS 11+12+14+15+17+18+19+21+22+23+24+27+28+29+30)		

NOTES: SOURCE FOR INVESTMENT AND CAPITAL COSTS, ARMIS 43-04; SOURCE FOR OTHER COSTS, ARMIS 43-01.

ATTACHMENT